Sec. 2-1990. - Debt policy.

(a) *Policy.*

(1) It is the policy of the city to appropriately and advantageously issue public debt in response to the ongoing capital needs of the city and its agencies. All debt will be issued in accordance with all applicable federal, state, City Charter, City Administrative Code, and City General Code of Ordinances requirements governing the issuance of public debt.

(2) The city's debt policy is the guideline for city staff to use in issuing debt. The policy shall be reviewed on an annual basis by the CFO/director of finance. Any substantive modifications made to the policy must be approved by the city council.

(b) *Authority.*

(1) Under the authority granted by the State Constitution and the City Charter, the city council is authorized to incur debt for funding capital improvement projects and capital equipment. It is the city councils intent to responsibly use this authority in order to fulfill the objectives of the city and its agencies.

(2) Management responsibility for the city's debt program is hereby delegated to the CFO/director of finance, who through the city treasurer shall establish written procedures for the operation of the debt program consistent with this debt policy, sections 807 and 831 of the City Charter and the city's Code of Ordinances. Pursuant to the conditions outlined in subsection (g) of this policy and subsequent legislative approval of the city council, it shall be the sole responsibility of the CFO/director of finance to issue debt on behalf of the city.

(c) *Prudence.*

(1) Debt shall be issued with judgment and care—under circumstances then prevailing—which persons of prudence, discretion and intelligence exercise in the management of their own affairs. The standard of prudence to be used by debt issuance officials shall be the prudent person standard and shall be applied in the context of managing an overall debt portfolio.

(2) Debt managers acting in accordance with the debt policy and written procedures and exercising due diligence shall be relieved of personal liability for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and appropriate action is taken to control adverse developments. The prudent person is expected to be a reasonably well informed person, not an investment banker or marketmaker, who is obligated to act responsibly.

(d) *Ethics and conflict of interest.*

(1) Officers and employees involved in the debt issuance process shall refrain from personal business activity that could conflict with proper execution of the debt program, or which could impair their ability to make impartial debt issuance decisions.

(2) Employees and debt issuance officials shall disclose to the CFO/director of finance any material financial interests in financial institutions that conduct business within this jurisdiction, and they shall further disclose any large personal financial positions that could be related to the city's debt portfolio.

(e) *Scope.*

(1) This debt policy applies to debt issued directly by the city and debt issued on behalf of the city by its agencies. Among the city's agencies are the following: Kansas City Municipal Assistance Corporation (KCMAC), Land Clearance for Redevelopment Authority (LCRA), Planned Industrial Expansion Authority (PIEA), Industrial Development Authority (IDA), and Tax Increment Financing Commission (TIF). This policy also provides guidelines regarding the execution of capital leases between conduit issuers such as the Missouri Development Finance Board (MDFB) and the city to finance capital improvement projects. The use of the term "city" in

this policy shall include the city and its agencies solely when debt is secured by the general credit of the city.

(2) This debt policy shall be all-inclusive of debt issued by the city to include, but not be limited to: general obligation debt, governmental purpose revenue debt for public enterprises water, sewer, storm water and airports, special assessment debt, sales tax and hospitality tax debt, economic development related debt, lease obligations, certificates of participation, debt derivatives and all forms of debt having an annual appropriation of city revenues. Additionally, this policy governs the use of any swap transactions used in conjunction with the city's debt program.

(3) This debt policy contains certain elements on procedures and practices to achieve the objectives of the policy and to ensure that professional standards are defined and met in the policy's implementation. In numerous specified cases within this policy, these procedures and policies are adopted by reference from the Government Finance Officers Association (GFOA) published recommended practices for debt management. These best practices are amended over time, and this policy incorporates these ongoing changes. This policy concludes with a glossary of terms frequently used in the municipal debt industry and in this policy.

(f) *Objectives.*

(1) To preserve the public trust and ensure current decisions positively impact future citizens. The city shall achieve this objective by:

a. Providing ongoing information to elected officials, senior management and the public on the status of the city's debt program;

b. Evaluating each debt issue in accordance with this policy, as to its individual and cumulative impact;

c. Adhering to federal laws, state statutes and regulatory enactments, City Charter and Code of Ordinances.

(2) To minimize borrowing costs. The city shall minimize borrowing costs by:

a. Working with spending authorities to ensure that the tax-exempt status of bonds issued on that basis are maintained;

b. Striving to obtain the highest credit ratings possible within the overall objectives of the city;

c. Ensuring that the type of debt and debt structure selected employ criteria that ensure the advantageous marketing of each issue.

(3) To preserve access to capital markets. The city shall preserve access to the capital markets by:

a. Providing information to the general municipal market and its agents including regular continuing disclosure to its investors;

b. Maintaining future debt capacity.

(4) To ensure future financial flexibility. The city shall ensure financial flexibility by:

a. Maintaining debt levels within manageable ranges to ensure both legal and financial margins exist;

b. Negotiating all bond-related contracts, which provide for flexibility in meeting future capital requirements;

c. Using cost/benefit analysis to set optional prepayment provisions, which ensure proactive management of outstanding obligations.

(g) *Guidelines for use.*

(1) Debt is a financing tool which should be judiciously used when the city has legal, financial and market debt capacities and will be considered when some or all of the following conditions exist:

a. Estimated future revenue is sufficient to ensure the repayment of the debt obligation;

b. Other financing options have been explored and are not viable for the timely or economic acquisition or completion of a capital project;

c. A capital project is mandated by federal or state authorities with no other viable funding option available; and

d. The capital project or asset lends itself to debt financing rather than pay-as-you-go funding based on the expected useful life of the project and the city's ability to pay debt service.

e. Debt will not be used to fund ongoing operating expenses of the city.

f. Any city debt issued in support of a development project shall first be reviewed and approved under the auspices of the city's economic development policies and procedures.

(h) *Types of permitted debt.* The city has numerous choices regarding types of debt available to meet its financing objectives. The following is a listing of the types of permitted debt and general guidelines as to their use.

(1) General obligation (maximum term 20 years [51]).

a. General obligation (G.O.) bonds provide the investor with its most secure city transaction, because of the city's pledge of its unlimited authority to levy property taxes for debt service. G.O. bonds are authorized to be issued in the following variations: full faith and credit, double-barrel, and neighborhood improvement district (NID).

b. The sum of all G.O. debt outstanding (regardless of type) is governed by the city's statutory legal debt margin but must also conform to limitations on the general credit of the city. The city may obtain voter authority to issue G.O. bonds (excluding NIDs) by a four-sevenths vote at the general municipal, primary or general election day and two-thirds at all other elections.

1. General obligation bonds—Full faith and credit. To be issued for projects, which benefit the city as a whole. Principal and interest to be paid from city's debt levy assessed on all real and personal property.

2. Double-barrel (including public benefit districts). To be issued for purposes consistent with the voted authority. Principal and interest to be paid from a designated revenue source (e.g. sales tax, tax increment financing, etc.) or a special assessment on real property (e.g. sewer special assessment). Revenue shortfalls to be made up from the city's debt levy assessed on all real and personal property.

3. NID. To be issued for purposes consistent with the NID statute (RSMo §§ 67.453—64.475). Principal and interest to be paid from special assessments levied on properties within the NID. Revenue shortfalls are to be made up from the city's general municipal resources. The NID may obtain voter authority to issue NID bonds by a four-sevenths vote at the general municipal, primary or general election day and two-thirds at all other elections of qualified voters residing in the district; or by a petition of two-thirds of the owners of at least two-thirds by area of the real property within the district.

(2) Annual appropriation (maximum term 40 years [52]).

a. Bonds backed by the city's annual appropriation pledge most often have a dual security structure. Generally, they are first secured by the revenues of the particular project. If these revenues are insufficient, the city pledges to consider an annual appropriation from general municipal revenues for any shortfall. This secondary potential access to general municipal revenues in most cases significantly raises the credit quality of the issue. The rating agencies consider the annual appropriation pledge as a very serious commitment of the city, and as such any failure to appropriate on any given bond issue would in all probability lead to a downgrading of the city's general obligation credit rating. Therefore, the city will enter into any annual appropriation transaction with the full expectation of making whatever annual appropriations are necessary to fund debt service on a timely basis; however, the city council has the legal authority to choose not to appropriate on an annual basis.

b. The city will use annual appropriation debt when necessary to meet the strategic objectives of the city. Any use of annual appropriation debt will require certain security and risk mitigation measures in the structuring of the bonds. While each potential use may have its own unique conditions, the city will target its debt service coverage requirement of at least 125 percent of net available revenues for debt service plus appropriate debt service reserve amounts when necessary to mitigate the city's risk.

c. Listed below are four types of debt the city may secure with its annual appropriation pledge:

1. Lease-backed debt. The city may issue tax-exempt and taxable leasehold revenue bonds and special limited obligation bonds (including redevelopment bonds) through not-for-profit municipal corporations such as KCMAC or by using a trust structure. Projects are primarily to be limited to public purpose capital improvements. Principal and interest to be paid from project revenues or specific taxes. Capital leases are not considered an indebtedness of the city according to state statute because the lease payments are subject to annual appropriation; however, from a variety of perspectives (e.g. credit, accounting, etc.) all or most of this type of debt may be considered an obligation of the city.

2. Conduit debt. The city may issue bonds through conduit agencies (e.g. LCRA, TIFC, etc.) provided that the projects financed have a general public purpose (e.g. infrastructure, economic development, housing, health facilities, etc.) consistent with the city's overall operating and capital plans. Principal and interest to be paid from project revenues or specific taxes.

3. Lease purchase. The city may enter short-term lease-purchase agreements to finance capital improvements, including equipment with an expected useful life (as defined by the governmental accounting standards board) of less than ten years. Principal and interest to be paid from the operating budget or other dedicated resources of the department purchasing equipment or constructing capital improvement.

4. Certificates of participation (COPs). A form of lease obligation in which the city enters into an agreement to pay a fixed amount annually to a third party, usually a nonprofit agency or a private leasing company or trust structure, subject to annual appropriation.

(3) Revenue (maximum term 35 years [53]).

a. Revenue bonds may be issued to fund capital improvements related to municipal enterprise functions (e.g. water, sewer, airport, etc.) or for special projects supported by discrete revenue sources. They are designed to be self-supporting through user fees or other special earmarked receipts or taxes and do not rely on the general taxing powers of the city. Principal and interest is paid from net revenues from enterprise operations or directly from the earmarked revenue source.

b. Governing bond ordinances and/or coverage ratios determine maximum allowable indebtedness. Financial feasibility studies are performed for each project to provide assurances as to the adequacy of dedicated revenue sources.

c. The city may obtain voter authority to issue revenue bonds by a simple majority at any election. Revenue bonds secured by certain dedicated revenue streams, such as sales and hospitality taxes, are also authorized by referendum. Revenue bonds secured by a broad based tax such as sales are considered by the rating agencies as on a par with general obligation bonds in determining the city's debt burden.

(4) Industrial revenue (maximum term 10 years [54]). The city may issue industrial revenue bonds (per RSMo ch. 100) for purposes consistent with state law, which include but are not limited to:

improvement of warehouses, industrial plants, buildings, machinery, etc. In this case, the city acts as a conduit issuer, as defined under federal law and state statute, on behalf of a private or non-profit party. Chapter 100 bonds are not included in the city's debt burden because they are secured solely by revenues of the private or non-profit party. Principal and interest on chapter 100 bonds is paid solely from the net revenues of the project. Issuance of these bonds does not constitute a general obligation of the city.

(5) Temporary loans/interfund borrowing (maximum term 270 days [55]).

a. In accordance with section 806 of the City Charter, the CFO/director of finance may borrow monies from other city funds:

1. To meet the operating and capital cash requirements of any other fund in anticipation of the receipts from revenues for the current fiscal year. All such loans shall be repaid on or before the due date out of the receipts from revenues of the fiscal year in which they are incurred, and shall become due within not more than nine months from the date of incurring the loan obligation, and in no event beyond the end of the fiscal year in which made; or

2. To finance capital improvements from anticipated receipts of revenues for the current calendar year, plus any unencumbered balances from previous years. All such loans shall become due within not more than nine months from the date of incurring the loan obligation; or

3. To meet the operating and capital cash requirements of another fund, may by ordinance authorize the borrowing of monies from the unreserved and undesignated fund balances of a fund provided that the city council makes provision for repayment within a designated time and provided that the repayments include interest at a reasonable rate; or

b. To borrow monies from non-city sources, using bonding authority approved by the voters or the city council to finance capital improvements in anticipation of issuing bonds to refinance the loan. All such loans shall become due within not more than nine months from the date of incurring the loan obligation. The city may not use revenues authorized for repayment of bonded indebtedness for repayment of such loans unless the loan is made pursuant to voted authority.

(6) Debt derivatives (maximum term not to exceed term of underlying debt). In conjunction with the city's debt program, and as permitted by state law, the director of finance/CFO shall be permitted to enter into interest rate swaps, forward swaps, swap options, basis swaps, caps, floors, collars, cancellation options or any similar hedge, derivative or synthetic instrument on behalf of the city (swap transactions). All swap transactions shall be administered and executed pursuant to the city's debt derivative policy, codified in section 2-1990(n), which does not allow the use of such products in the city's investment of funds.

(i) *Debt structuring and marketing.*

(1) *Fixed or variable rate debt.*

a. The city's debt portfolio may at any given time be comprised of a combination of both fixed and variable rate debt. The city will always seek to manage its debt portfolio, including the absolute amount(s) of outstanding fixed and variable rate debt, in a manner which best supports the city's long-term financial condition. The city will generally issue its debt on a fixed interest rate basis, wherein at the time of the bond sale all interest rates are known and do not change while those bonds are outstanding. Particular conditions may arise where the city would consider the use of variable interest rate bonds. Variable interest rate bonds have interest rates that reset on a periodic basis (e.g. daily, weekly, monthly, etc.). Conditions which would cause a consideration of variable rate debt are:

- Adverse fixed-rate municipal market;

- Uncertainty or variability of the amount of annual revenues for debt service;
- The potential for a rapid repayment of debt; or
- The need or desire to maximize the city's asset/liability balance

b. Variable interest rate debt exposes the city to interest rate risk over the term of the financing. While the credit rating agencies are supportive of an issuer of the magnitude of the city having a certain amount of unhedged variable rate debt, they suggest the aggregate amount be capped at a level not exceeding 20—25 percent of all comparable debt outstanding. Their guideline is generally applied to variable rate debt which has no other significant risk mitigation factors.

c. Once variable rate debt is issued, the city may employ various risk mitigation factors including natural hedging of its short-term liabilities (i.e., variable rate debt) with its substantial short-term assets to create a net financial margin (i.e., cash management investment portfolio) or the use of derivatives, specifically interest rate hedges. From a debt portfolio management perspective, the city will also seek the optimal mix of hedged and unhedged variable rate debt, which best fits the city's long-term credit and financial profile.

(2) *Taxable vs. tax-exempt debt.* The city shall first seek to issue and/or guarantee only tax-exempt debt and avoid taxable debt in order to reduce interest expense. However, the city recognizes that not all financings will be able to be completed on a tax-exempt basis and therefore reserves the right to participate in taxable financings. For tax-exempt debt issuances, the CFO/director of finance is hereby delegated the authority to declare the official intent of the city to reimburse itself for certain expenditures made within 60 days prior to or on and after the date of such declaration in accord with treasury regulation 1.150-2. Such intent will be documented in a memo to the file with copies to bond counsel, the city manager and the chair of the finance committee.

(3) *Repayment term.* The city will structure its debt to comply with all federal and state and local requirements as to repayment terms. The city will seek to repay its debt in an expeditious manner within the city's overall financial objectives.

(4) *Prepayment provisions.*

a. Redemption provisions and call features shall be evaluated in the context of each bond sale to enhance marketability of the bonds; to ensure flexibility related to potential early redemption; to foster future refunding transactions; or in consideration of special conditions of the transaction. The potential of additional costs (i.e., call premium) and higher interest rates as a result of including a call provision shall also be evaluated.

b. The following are the different redemption provisions to be evaluated:

1. Optional redemption. The ability of the city to redeem bonds early.
2. Mandatory redemption. Provisions associated in redeeming bonds under certain predetermined conditions.
3. Extraordinary redemption. The ability to redeem bonds to address fortuitous events.

(5) *Credit enhancement.* When the city is considering the purchase of bond insurance, it will determine its cost-effectiveness in the marketing of particular bond issues. The cost-effectiveness will be based on the premium cost of the insurance as compared to the estimated difference in the true interest cost (TIC) of an insured versus uninsured bond issue. In most competitive sales, a purchasers option approach to the acquisition of bond insurance will be used.

(6) *Method of sale.* The CFO/director of finance will select the method of sale, which best fits the type of bonds being sold, market conditions, and the desire to structure bond maturities to

enhance the overall performance of the entire debt portfolio. Three general methods exist for the sale of municipal bonds:

a. *Competitive sale.* Bonds are marketed to a wide audience of investment banking (underwriting) firms. Their bids are submitted at a specified time. The underwriter is selected based on its best bid for its securities. Pursuant to this policy, and within the parameters approved by the city council, the CFO/director of finance is hereby authorized to sign the bid form on behalf of the city fixing the interest rates on bonds sold on a competitive basis.

b. *Negotiated sale.* The city selects the underwriter or group of underwriters of its securities in advance of the bond sale. The city financing team works with the underwriter to bring the issue to market and negotiates all rates and terms of the sale. In advance of the sale, the city will determine compensation for and liability of each underwriter employed and the designation rules and priority of orders under which the sale itself will be conducted (e.g., retail, group net, net designated, etc.). Pursuant to this policy, and within the parameters approved by the city council, the CFO/director of finance is hereby authorized to sign the bond purchase agreement on behalf of the city fixing the interest rates on bonds sold on a negotiated basis.

c. *Private placement.* The city sells its bonds to a limited number of sophisticated investors, and not the general public. Private placement bonds are often characterized as having higher risk or a specific type of investor base.

(7) *Award of sale.* The city and its agencies will award the sale of their competitively sold bonds on a true interest cost (TIC) basis. A TIC basis considers the time value of money in its calculation.

(j) *Retention of consultants and other related parties.* The city recognizes the nature of the municipal bond industry is such that specialized consultants may need to be retained. The city will strive to retain those consultants who will best advise them on individual issues and the overall city debt program in a manner, which will most advantageously position the city on both a short and long-term basis. In general, a competitive selection process will be used in the retention of any consultants; however, the CFO/director of finance may also directly engage consultants on a case-by-case basis. At the discretion of the committee chair, a member of the city council standing committee cognizant of debt matters may be asked to serve on a selection committee for retention of consultants and other related parties.

(1) *Bond/swap counsel*. The city attorney will maintain responsibility for selection and procurement of bond and swap counsel. Bond and swap counsel will be retained who are recognized by the bond market (Red Book) and who have extensive expertise in the public finance areas commensurate with the needs of the city.

(2) *Financial advisors*.

a. The city will select financial advisors who may either be independent financial advisors or firms who engage in municipal bond underwriting or brokerage services. While serving as the city's financial advisor, a firm may not also engage in the underwriting of the city bond issue for which that firm acts as financial advisor. A firm may also not switch roles (i.e., from financial advisor to underwriter) after a financial transaction has begun.

b. Financial advisors shall be selected through a competitive process after a review of proposals by a committee, which may include a member of the city council standing committee cognizant of debt matters and city staff.

c. During the contract term of any party acting as financial advisor, neither the firm nor any individual employed by that firm will perform financial advisory, investment banking or similar services for any entity other than the city in transactions involving a city financial commitment without the specific direction of the city's CFO/director of finance.

(3) *Underwriters.* For negotiated sales, the city will generally select or pre-qualify underwriters through a competitive process. This process may include a request for proposal or qualifications

to all firms considered appropriate for the underwriting of a particular issue or type of bonds. The city will determine the appropriate method to evaluate the underwriter submittals and then select or qualify firms on that basis. The city will not be bound by the terms and conditions of any underwriting agreement, oral or written, to which it was not a party.

(4) *Other parties.* Depending on the specific bond issue, other parties customary in the bond issuance process may need to be engaged (e.g. trustee banks, printers, dissemination agents, bond insurers, etc.). The city will retain those parties which are first acceptable to the municipal market for that particular issue, and then having those characteristics of professional standing and cost-effectiveness.

(k) *Guidelines for debt management.*

(1) Proactive debt management is a key component to the immediate and long-term success of the city's financial objectives. A successful debt management program begins with comprehensive information on the current debt program status and definition of the future direction of the city's capital financing objectives. Within this context, the city structures and markets individual bond issues to complement these objectives.

(2) Once issued, the professional oversight of individual issues and the ongoing context of the city's debt program will permit the recognition of future opportunities and the advantageous positioning of the overall program.

a. *Disclosure.*

1. Disclosure is both a regulatory requirement and a highly advisable means to enhance the marketing of the city's bonds. The Securities and Exchange Commission (SEC) regulates both primary disclosure, the initial marketing of a bond issue, and continuing disclosure, the ongoing information to the market about the status of the issue and issuer. The regulations place responsibility for primary disclosure on underwriters, and on issuers for continuing disclosure.

2. Failure by the city to properly manage primary disclosure and to timely provide its continuing disclosure may have adverse impacts on its credit ratings and access to the tax-exempt capital market. It may also subject the city to regulatory actions from both the SEC and IRS.

3. Adequate disclosure on both a primary and continuing basis can enhance the marketability of the city's bonds by providing potential investors with current and professional information regarding the city. Timely and accurate completion of these tasks both influences investors decisions on purchasing the city's bonds and contributes to the competitive audience for the city's bonds. The city will fully comply with disclosure regulations.

A. *Primary.* In the preparation of official statements the city will follow professional and market standards in the presentation of its issues and issuers. It will facilitate the distribution of the official statements in a timely manner to allow investors adequate time to make their investment decisions in an informed manner. The city will execute continuing disclosure undertakings in a manner to fully comply with regulatory provisions and ensure a full disclosure of appropriate information to the market.

B. *Secondary.* The city will meet all substantive and time requirements in its annual continuing disclosure filings, which include making the city's CAFR available to the public 180—270 days after the fiscal year end. The city will keep current with any changes in both the administrative aspects of its filing requirements and the national repositories responsible for ensuring issuer compliance with the continuing disclosure regulations. In the event a material event occurs requiring immediate disclosure, the city will ensure information flows to the appropriate disclosure notification parties.

(3) *Debt target.* Maintaining an appropriate level of indebtedness is important to preserve flexibility for future infrastructure investments and to position for high credit quality. Each type of debt has its own appropriate level. The appropriate levels are internally determined based on a variety of factors, such as: infrastructure investment needs of the particular service area, capacity to repay debt from the specific revenue source, and the sectors credit rating objectives. Since these factors can change over time, any debt guideline must be periodically reviewed to reflect evolving city conditions. Certain types of debt may have different applications but are treated as one type by the credit rating agencies. Therefore, the city may develop guidelines which reflect both the use of the debt type and its contribution to the credit rating debt burden.

a. *General obligation and annual appropriation.* General obligation and annual appropriation-backed bonds present both individual and collective financial impacts. Individually, they place actual or potential demands on general municipal revenue sources. Collectively, they are reviewed by the credit rating agencies as to their cumulative impact on these revenue sources. Guidelines for their individual and overall levels assist in the ongoing evaluation of these impacts. As part of the debt management program, city staff will report the following three debt ratios to the city council, which are routinely reviewed by the credit rating agencies:

- Tax-supported debt outstanding as a percent of market value
- Tax-supported debt outstanding per capita
- Tax-supported debt service as a percent of general municipal revenues (GMR)

Additionally, the city council will utilize the following two guidelines to ensure general obligation indebtedness is maintained within constitutional debt limitations and non self-supporting (net) tax-supported debt outstanding is maintained within a targeted range:

- General Obligation Debt Outstanding as a Percent of Assessed Valuation .....0<20%
- Net Tax-Supported Debt Service as a Percent of Net GMR .....5—15%

b. *Revenue.* Each type of revenue bond indebtedness has an estimated capacity dictated by financial position, user rate revenue generation capability and existing and anticipated future debt requirements. Revenue bonds may also have legal restrictions on the amount of parity debt that may be issued based on an additional bonds covenant for existing debt. The debt capacity guidelines for each type of revenue bond indebtedness will be governed by their specific bond covenant requirements.

(4) *Credit rating strategy.* High credit quality is essential to the cost-effective financing of the city's capital needs. The city maintains a variety of credit ratings based on the diversity of its issuers and activities. In all cases, the city will strive to obtain the highest credit ratings possible within the parameters of each credit. The CFO/director of finance will develop appropriate credit rating strategies for each of the city's discrete credits and will update the city council regarding all credit rating events.

a. *Rating agency choice.*

1. Three national agencies are currently prominent in the municipal market; Standard & Poor's, Moody's Investors Service and Fitch Investors Service. Since the city's bonds attract a national underwriter and investor audience, the city will obtain ratings from those agencies that are most attractive to the specific audience.
2. The retention of a rating agency relationship will be based on a determination of the potential for more favorable interest costs as compared to the direct and indirect cost of maintaining that relationship.

b. *Information program.* The city will maintain a multi-faceted information program, which will include:

- Providing new informational materials to the agencies, on a periodic basis.

- Delivering rating presentations in the appropriate form prior to any bond sale.
- Seeking opportunities to have the agencies tour the city at times not necessarily associated with a bond sale to update them on the changes to the community.
- Working with other governmental entities impacting the city's rating to coordinate both the substance and presentation of the city's credit ratings case.

c. *Statistical analyses.* The city will maintain an ongoing statistical base of primary credit quality indicators to measure its standing over time.

(5) *Bond financial advisory committee.* In accord with city ordinance, the city may engage a bond financial advisory committee, appointed by the mayor, to advise the mayor and council on matters relating to the following: timing of bond issuance, debt capacity, prevailing interest rates, municipal budget considerations and compliance with bond authorization ballot language.

(6) *Defeasance, prepayment and refunding.*

a. The accelerated retirement and restructuring of debt can be valuable debt management tools. Accelerated retirement occurs through the use of defeasance and the exercise of prepayment provisions. Debt is often restructured to the benefit of the city through the issuance of refunding bonds.

b. Defeasance can occur when funds are accumulated in a dedicated debt service fund or other available reserve to place in an irrevocable escrow account an amount sufficient such that the initial deposit plus accumulated investment earnings pay all scheduled debt service obligations on the refunded bonds until an optional prepayment date, at which time all remaining refunded bonds are retired.

c. In the case of dedicated debt service funds, the city will monitor such fund balances and will periodically review the advisability of defeasing related bonds. In the case of other available reserves, the city will periodically analyze the financial trade-offs of defeasing or other advantageous uses of these funds.

d. Prepayment provisions are structured into the original bond issue to provide the city with opportunities to manage the issue. These opportunities take the form of using cash to reduce all or a portion of outstanding principal and future debt service obligations. Prepayment provisions play a major part in the economics of refunding debt.

e. The city will monitor the prepayment provisions on its outstanding debt to realize both of these potential opportunities. By monitoring its debt service funds the city can gauge its ability to prepay debt. Debt can be refunded to achieve one or more of the following objectives:

- Reduce future interest costs;
- Restructure future debt service in response to evolving conditions regarding anticipated revenue sources; and
- Restructure the legal requirements, termed covenants of the original issue to reflect more closely the changing conditions of the city or the type of bond.

f. The IRS promulgates specific rules regarding the tax-exempt refunding of outstanding issues. Refundings have two general categories:

1. *Current refunding.* Refunding bonds are settled within 90 days of an optional prepayment date.
2. *Advance refunding.* Refunding bonds are settled more than 90 days in advance of an optional prepayment date. The federal restrictions are that any issue can only be advance refunded once on a tax-exempt basis.

g. Because these two broad refunding categories encompass a number of bond structuring techniques, the city will evaluate each technique on a case-by-case basis given the objectives of the specific issue. Management guidelines for refundings vary by both type and purpose.

h. If the objectives of the refunding are to either redefine bond covenants or restructure debt service, then the city shall evaluate the merits of those situations with a diminished concern over reductions in future interest payments.

i. If the objective is to reduce future interest costs, then the city will consider whether the issue is a current or advance refunding.

j. For a current refunding the city will consider the absolute interest costs savings on both net present and future value bases. For an advance refunding the city will look to more rigorous quantifiable net savings measures.

k. Although the city recognizes the latitude it requires given the range of its debt types, the city will generally look to a net present value savings in a range from three percent to five percent of the present value of the refunding bonds.

l. A refunding that relies on a swap transaction to achieve present value savings is generally called a synthetic refunding. Given their added complexity, the city will enter into synthetic refundings only after significant internal review in accord with the city's swap policy. As such, the city will apply both its general refunding and swap guidelines when reviewing synthetic refunding proposals. All approved synthetic refundings should achieve results superior to those available in the conventional market.

(7) *Investment of bond proceeds.* The investment of bond proceeds requires significant diligence in meeting the objectives of regulatory compliance, the management of the flow of funds described in bond documents, and the needs of the projects being funded. The investment of bond proceeds should be considered at the outset of every debt issuance and integrated throughout the process. As one part of the city's investment management program, this policy incorporates by reference the GFOAs recommended practice, investment of bond proceeds and the city's investment policy.

a. *Maintenance of records.* The city will maintain appropriate records in accordance with federal, state and city requirements, and in accordance with its bond documents to fully meet their provisions and provide for ease of any reporting requirements.

b. *Arbitrage/rebate liability.* The city will structure and time its bond issues such that the investment of bond proceeds will minimize any arbitrage/rebate liability.

c. *Escrow investments.* The city will take such steps as necessary to ensure that investments placed in escrow fully comply with regulatory provisions. Where appropriate the city will use state and local government securities (SLGS), and in those conditions where federal open market securities are used, the city will seek at minimum three competitive bids for the placement of these securities.

(8) *Federal arbitrage and rebate compliance.*

a. The city will fully comply with federal arbitrage and rebate regulations. Concurrent with this policy, the city will take all permitted steps to minimize any rebate liability through proactive management in the structuring and oversight of its individual debt issues. All of the city's tax-exempt issues, including lease purchase agreements, are subject to arbitrage compliance regulations.

b. The finance department and the requesting departments shall be responsible for the following:

1. Using bond proceeds only for the purpose and authority for which the bonds were issued. Tax-exempt bonds will not be issued unless it can be demonstrated that 85 percent of the proceeds will be expended within the three-year temporary period.

2. Performing arbitrage rebate calculations on construction funds, as determined by the IRS.

3. Performing arbitrage rebate computations no later than each five-year anniversary date of the issuance and at the final maturity for all bonds.

4. Examining whether the city met the arbitrage rebate exception calculation rules.

5. Maintaining detailed investment records, including purchase prices, sale prices and comparable market prices for all securities.

6. Monitoring the expenditure of bond proceeds and exercising best efforts to spend bond proceeds in such a manner that the city shall meet one of the spend-down exemptions from arbitrage rebate.

7. Monitoring the investment of bond proceeds with awareness of rules pertaining to yield restrictions.

c. To the extent any arbitrage rebate liability exists, the city will report such liability in its comprehensive annual financial report (CAFR).

(9) *Monitoring of covenant compliance.* The city's revenue bonds generally have a number of bond covenants requiring ongoing compliance and conditions for future bond issuance on an equal security (parity) basis. The city will maintain a compliance monitoring system by revenue bond type of all bond covenants. This system will specifically report information on coverage, rate and additional bond covenant compliance. The system will track trends in coverage levels over time and capacity availability under additional bonds covenants.

(10) *Debt service cash flow monitoring.* The city has a large variety of debt repayment sources, with a wide range of variability and predictability. The city understands the essentiality of proper management and forecasting of future revenues for debt service. This essentiality is embodied in its ability to make timely payment of debt obligations, comply with legal restrictions, and forecast the revenue impacts on policy decisions. The city shall maintain a system of debt service revenue forecasting for each of its major debt categories.

(11) *Referendum approved capacity.* The city can only obtain authority to issue general obligation and revenue debt through referendum approval. The city often seeks referendum approval for a program of capital finance covering a number of years. The city will both monitor the absorption of referendum approved capacity over time and meet any commitments made, absent exigent circumstances, at the time of the public vote.

(l) *Reporting.* The finance department is charged with the responsibility of preparing monthly financial reports. Within the monthly financial report a summary of the city's debt portfolio shall be included listing of all city's outstanding debt by type including the outstanding principal amount for each. Additionally, pursuant to subsection (k)a. of this debt policy, the monthly financial report shall also include a calculation of debt capacity for the general municipal debt of the city (i.e., excludes enterprise-related revenue bonds). On an annual basis, the finance department will prepare all required debt related schedules and footnotes for inclusion in the city's comprehensive annual financial report.

(m) *Glossary.*

(1) *Arbitrage.* Investment earnings representing the difference between interest paid on bonds and the interest earned on securities in which bond proceeds are invested. The Internal Revenue Code regulates the amount and conditions under which arbitrage on the investment of bond proceeds is permissible and the 1986 Tax Reform Act requires, with limited exceptions, that arbitrage from investments must be rebated to the federal government.

(2) *Basis point.* One basis point is 1/100 of 1 percent (0.01 percent). One hundred basis points equal 1 percent.

(3) *Bond insurance.* Insurance as to timely payment of interest and principal of a bond issue. The cost of insurance is usually paid by the issuer in the case of a new issue of bonds, and the insurance is not purchased unless the cost is more than offset by the lower interest rate that can be incurred by the use of the insurance.

(4) *Bond year.* An element in calculating average life of an issue and in calculating net interest cost and net interest rate on an issue. A bond year is the number of 12-month intervals between the date of the bond and its maturity date, measured in $1,000 increments. For example, the "bond years" allocable to a $5,000 bond dated April 1, Year 1, and maturing June 1, Year 2, is 5.830 [1.166 (14 months divided by 12 months) × 5 (number of $1,000 increments in $5,000 bond)]. Usual computations include "bond years" per maturity or per an interest rate, and total "bond years" for the issue.

(5) *Call.* Actions taken to pay the principal amount of the bonds prior to the stated maturity date, in accordance with the provisions for "call" stated in the proceedings and the bonds.

(6) *Callable.* Subject to payment of the principal amount (and accrued interest) prior to the stated maturity date, with or without payment of a call premium.

(7) *Call premium.* A dollar amount, usually stated as a percentage of the principal amount called, paid as a "penalty" or a "premium" for the exercise of a call provision.

(8) *Closing date.* The date on which a new issuance of bonds is delivered to the purchaser upon payment of the purchase price and the satisfaction of all conditions specified in the bond purchase agreement.

(9) *Coverage.* This is a term usually connected with revenue bonds. The margin of safety for payment of debt service, reflecting the number of times (e.g. "120 percent coverage") by which annual revenues either on a gross or net basis exceed annual debt service.

(10) *Dated date (or issue date).* The date of a bond issue from which the bondholder is entitled to receive interest, even though the bonds may actually be delivered at some other date.

(11) *Debt limit.* Statutory or constitutional limit on the principal amount of debt that an issuer may incur (or that it may have outstanding at any one time).

(12) *Debt service.* Principal and interest.

(13) *Depository.* A clearing agency registered with the Securities and Exchange Commission which provides immobilization, safekeeping and book-entry settlement services to its participants. The four registered depositories are The Depository Trust Company (New York), the Midwest Securities Trust Company (Chicago), the Pacific Securities Depository Trust Company (Chicago) and the Philadelphia Depository Trust Company.

(14) *Discount.*

   a. Amount (stated in dollars or a percent) by which the selling or purchase price of a security is less than its face amount.

   b. Amount by which the amount bid for an issue is less than the aggregate principal amount of that issue.

(15) *General municipal expenditures (GME).* Expenditures for general municipal purposes including those for general fund-supported, special revenue and assessment programs but excluding enterprise funds.

(16) *General municipal revenues (GMR).* Revenues available to pay for general municipal expenses and collected from general municipal sources (e.g., taxes, fees, rentals, etc.) including general fund-supported, special revenue and assessment programs but excluding enterprise funds (i.e., water, sewer and airport).

(17) *Issue date (or dated date).* The date of a bond issue from which the bondholder is entitled to receive interest, even though the bonds may actually be delivered at some other date.

(18) *Joint managers.* Underwriting accounts are headed by a manager. When an account is made up of several groups of underwriting firms that normally function as separate accounts, the larger account is often managed by several underwriters, usually one from each of the several groups, and these managers are referred to as "joint managers."

(19) *Legal opinion.* An opinion of bond counsel concerning the validity of a securities issue with respect to statutory authority, constitutionality, procedural conformity and usually the exemption of interest from federal income taxes.

(20) *Letter of credit (LOC).* A security document usually issued by a bank that back-stops, or enhances, the basic security behind a bond. In the case of a direct pay "LOC," the bondholder can request the bank to make payment directly rather than through the issuer, in which case the city agrees to promptly repay the bank or pay the bank in advance.

(21) *Level debt service.* The result of a maturity schedule that has increasing principal amounts maturing each year so that the debt service in all years is essentially "level." "Level debt service" is often used with revenue bond issues (and, in a familiar area, in the traditional approach to monthly payments on home mortgages).

(22) *Maturity date.* The stated date on which all or a portion of the principal amount of a security is due and payable.

(23) *Maturity schedule.* The schedule (by dates and amounts) of principal maturities of an issue.

(24) *Net direct debt.* Total direct debt of a municipality less all self-supporting debt, any sinking funds and short-term debt such as tax anticipation notes and revenue anticipation notes.

(25) *Net general municipal revenues.* Aggregate general municipal revenues less those dedicated, earmarked, redirected or otherwise legally unavailable to pay net tax-supported debt service.

(26) *Net interest cost.* The traditional method of calculating bids for new issues of municipal securities. The total dollar amount of interest over the life of the bonds is adjusted by the amount of premium or discount bid, and then reduced to an average annual rate. The other method is known as the true interest cost (see "true interest cost").

(27) *Net tax-supported debt service.* Annual principal and interest due for aggregate tax-supported debt less any principal and interest due for tax-supported debt determined to be self-supporting (i.e., annual debt service is fully paid from dedicated taxes, fees, incremental revenues, etc.).

(28) *Notice of sale.* An official document disseminated by an issuer of municipal securities that gives pertinent information regarding an upcoming bond issue and invites bids from prospective underwriters.

(29) *Optional redemption.* A right to retire an issue or a portion thereof prior to the stated maturity thereof during a specified period of years. The right can be exercised at the option of the issuer or, in pass-through issues, of the primary obligor. "Optional redemption" may require the payment of a premium for its exercise, with the amount of the premium decreasing the nearer the option exercise date is to the final maturity date of the issue.

(30) *Overlapping debt.* On a municipal issuer's financial statement "overlapping debt" is the debt of other issuers which is payable in whole or in part by taxpayers of the subject issuer.

As an example, a county usually includes several smaller government units and its debt is apportioned to them for payment based on the ratio of the assessed value of each smaller unit to the assessed value of the county. Another example is when a school district includes two or more municipalities within its bounds.

(31) *Par value.* The principal amount of a bond or note due at maturity.

(32) *Paying agent.* Place where principal and interest are payable. Usually a designated bank or the office of the treasurer of the issuer.

(33) *Syndicate.* A group of underwriters formed for the purpose of participating jointly in the initial public offering of a new issue of municipal securities. The terms under which a "syndicate" is formed and operates are typically set forth in the "agreement among underwriters." Those terms will establish the pro rata participation of each syndicate member; the methods by which offering prices and other terms of sale will be established; in what priority orders for securities will be taken and confirmed; and the joint or several nature of the liability assumed by each member for the purchase of unsold securities. The purpose of a "syndicate" formation is to share the risk of the offering among participating underwriters and to establish a distribution network in which to market the offered securities. One or more underwriters will act as manager of the "syndicate" and one of the managers will act as lead manager and "run the books." A "syndicate" is also often referred to as an "account" or "underwriting account."

(34) *Tax-supported debt outstanding.* Total principal amount of city debt outstanding excluding any debt issued for public enterprises including water, sewer and airport bonds.

(35) *Tax-supported debt service.* Annual principal and interest due for aggregate tax-supported debt.

(36) *True interest cost.* A method of calculating bids for new issues of municipal securities that takes into consideration the time value of money (see "net interest cost").

(37) *Trustee.* A bank designated by the issuer as the custodian of funds and official representative of bondholders. "Trustees" are appointed to insure compliance with the contract and represent bondholders to enforce their contract with the issuers.

(38) *Underwriting spread.* The difference between the offering price to the public by the underwriter and the purchase price the underwriter pays to the issuer. The underwriter's profit, expenses and selling costs are usually paid from this amount.

Glossary Source: Public Securities Association, Fundamentals of Municipal Bonds, Third Edition.

(n) *Debt derivative policy*

(1) *Policy.*

a. It is the policy of the city to undertake debt derivatives in the form of swap transactions to meet the debt management goals of the city and its agencies. All swap transactions will be executed in a manner conforming to all applicable federal, state, City Charter, City Administrative Code, and City General Code of Ordinances requirements.

b. The city's debt derivative policy is the standard guideline for city staff to use in entering into swap transactions. The policy shall be reviewed on an annual basis by the CFO/director of finance and any modifications made thereto must be approved by the city council.

(2) *Authority.*

a. As permitted by state law, the CFO/director of finance may enter into interest rate swaps, forward swaps, swap options, basis swaps, caps, floors, collars, cancellation options or any similar hedge, derivative or synthetic instrument on behalf of the city. For the purposes of this policy, all such transactions are referred to hereinafter as swap transactions. All swap transactions shall be structured in accordance with this policy and authorized by the city council. This policy does not govern the use of such products in the city's investment of funds.

b. Management responsibility for the city's swap program is hereby delegated to the CFO/director of finance, who through the city treasurer shall establish written procedures for the operation of the swap program consistent with this policy. The CFO/director of finance will enter into swap transactions on behalf of the city.

(3) *Prudence.*

a. Swap transactions shall be undertaken with judgment and care—under circumstances then prevailing—which persons of prudence, discretion and intelligence exercise in the management of their own affairs. The standard of prudence to be used by finance staff shall be the prudent person standard and shall be applied in the context of managing an overall swap portfolio. The prudent person is expected to be a reasonably well informed person, not an investment banker or counterparty, who is obligated to act responsibly.

b. Finance staff acting in accordance with the swap policy and written procedures and exercising due diligence shall be relieved of personal liability for an individual swap transactions risks or market price changes, provided deviations from expectations are reported in a timely fashion and appropriate action is taken to control adverse developments.

(4) *Ethics and conflict of interest.* Officers and employees involved in the swap transaction process shall refrain from personal business activity that could conflict with proper execution of the swap program, or which could impair their ability to make impartial swap transaction decisions. Employees and swap transaction officials shall disclose to the CFO/director of finance any material financial interests in financial institutions that conduct business within this jurisdiction, and they shall further disclose any large personal financial positions that could be related to the city's swap portfolio.

(5) *Scope.*

a. This swap policy applies to all swap transactions of the City and its agencies. Among the city's agencies are the following: Kansas City Municipal Assistance Corporation (KCMAC), Land Clearance for Redevelopment Authority (LCRA), Planned Industrial Expansion Authority (PIEA), Industrial Development Authority (IDA), and Tax Increment Financing Commission (TIF). The use of the term "city" in this policy shall include the city and its agencies when swap transactions are used in conjunction with debt secured by the general credit of the city.

b. Each resolution to authorize entry into a swap transaction (each a swap resolution) shall set forth, where applicable, among other things, the notional amount, security, payment, and other financial terms of the swap transaction between city and qualified swap counterparties (counterparties). The swap resolution shall also approve, as to form, the operative agreements, contracts, and other documents to be used in the swap transaction. Counterparties shall satisfy the requirements of subsection (j) of this section.

c. Each swap resolution of the city council shall authorize the CFO/director of finance and/or his or her designee to make modifications to or finalize the terms of the swap transactions contemplated, within parameters established by the swap resolution. In the event of a conflict between a swap resolution or the documentation effectuating a swap transaction and this policy, the terms and conditions of the swap resolution or such documentation shall control.

(6) *Objectives.* Swap transactions can be an integral part of the city's asset/liability and debt management strategies. By utilizing interest rate swaps, the city can meet the following objectives:

a. Actively manage its liability interest rate risk.

b. Balance financial risk and achieve debt management goals.

c. Expeditiously take advantage of market opportunities to reduce costs.

d. Accomplish financial objectives not otherwise obtainable using traditional financing methods. The city shall not enter into interest rate swaps for speculative purposes. For the purposes of this section, speculation is considered the creation of positions that are inconsistent with the city's risk management objectives and/or are positions that create or distort the city's exposure to risks beyond the range normally encountered or that are created for the purpose of generating income for the city.

(7) *Guidelines for use.* The city shall include the following guidelines in the evaluation and recommendation of swap transactions:

a. Legality. The city, utilizing advice of counsel, must first determine that the proposed swap contract fits within the legal constraints imposed by applicable law, the city's trust agreement as amended and supplemented, city resolutions and other contracts

b. Goals. In conjunction with city council consideration of the swap resolution, the CFO/director of finance and/or his or her designee must clearly explain the goals to be achieved through the proposed swap transaction.

c. Rating agencies. The proposed swap transaction shall not have an adverse impact on any existing city credit rating. The swap transaction also shall conform to outstanding covenants made to credit enhancers, liquidity providers, surety providers, bondholders and other creditors. All swap transactions should be, but are not required to be, discussed with credit rating agencies then maintaining ratings on city debt prior to execution.

d. Tenor. The city shall determine the appropriate termination date for a swap transaction on a case-by-case basis. However, in no circumstance may the termination date of a swap transaction between the city and a counterparty extend beyond the final maturity date of the underlying debt.

e. Impact on variable rate debt capacity. The impact of the swap transaction on the city's variable rate debt capacity must be quantified prior to execution so as not to hinder the city's ability to issue variable rate debt or commercial paper.

f. Risks and benefits. City staff, in consultation with its financial advisor, should evaluate the costs, benefits, risks and other considerations regarding each particular swap transaction and should explain them to the city council, as part of the approval process for each swap transaction.

g. Debt constraints. The swap transaction shall not contain terms that restrict the ability of the city to comply with additional bonds tests or anti-dilution tests and shall not create cross defaults to city debt below prescribed threshold amounts.

h. Accounting implications. The city shall employ appropriate staff with responsibility and knowledge suitable for monitoring swap transactions. Before entering into a swap transaction, city staff shall analyze and prepare for the accounting impact of the swap on the city's comprehensive annual financial report (CAFR). The finance department will prepare all necessary CAFR reporting.

i. Exit strategy. The mechanics for determining termination values at various times and upon various occurrences must be explicit in the swap transaction, and the city should obtain estimates from its financial advisor and/or the counterparty regarding the potential termination costs which might occur under various scenarios, and plan for how such costs would be funded.

j. Basis of award. The CFO/director of finance is hereby authorized to enter into swap transactions on behalf of the city. The city's primary method for swap procurement will be either fully negotiated or quasi-competitive due to the limited number of qualified counterparties. The CFO/director of finance shall determine and recommend the procurement method for each swap transaction, as follows:

   1. Competitive bid. Competitive bid transactions will be quasi-competitive (i.e., include no fewer than three firms) among firms qualified under the terms of this policy. Under a quasi-competitive bid, the city may allow a firm or firms, if not submitting the best bid, to amend its bid or their bids to match the best bid, and by doing so, be awarded up to a specific percentage of the transaction. The quasi-competitive bid process allows the city to achieve diversification of its counterparty exposure. Prior to conducting a quasi-competitive bid, the city will establish clear parameters and mechanics in the bid solicitation.

2. Negotiated transaction. In the case of a negotiated transaction, the city council shall (i) set parameters; (ii) within the parameters established by the city council delegate to the CFO/finance director, in consultation with the city's financial or swap advisor, authority to negotiate the price; and (iii) arrange with the financial advisor for delivery of a "fair value opinion." The counterparty shall disclose to the city payments to third parties regarding the execution of any swap or derivative contract.

(8) *Authorized swap transactions.* The city may use the following swap transactions after identifying the specific financial objective to be realized and assessing the attendant risks:

a. Interest rate swaps—Immediate or forward starting floating-to-fixed rate swaps may be used to capture current market fixed interest rates or eliminate variable rate exposure. Fixed-to-floating rate swaps may be used to create additional variable interest rate exposure.

b. Interest rate caps, collars and floors—Financial contracts may be used to limit or bound exposure to interest rate volatility.

c. Options on swaps—Sales or purchases of options may be used to commence or cancel interest rate swaps.

d. Basis swaps—Floating-to-floating rate swaps may be used to manage basis or tax risk and change the basis on which variable cash flows are determined.

e. Rate locks—These are often based on interest rate swaps and may be used to hedge an upcoming fixed rate bond issue.

(9) *Form of swap transactions and other documentation.*

a. Each interest rate swap transaction shall contain terms and conditions as set forth in the International Swap and Derivatives Association, Inc. (ISDA) Master Agreement and such other terms and conditions included in any schedules, confirmations and credit support annexes as approved in accordance with the city's swap resolution pertaining to that swap transaction. All of the city's swap documentation shall be prepared and reviewed by qualified swap counsel, as procured by the city attorney.

b. For all swap transactions, the counterparty and the city's financial advisor shall each provide the city, a disclosure memorandum (which may or may not become part of the official transcript) that shall include an analysis of the risks and benefits, with amounts quantified. This analysis should include, among other things, a matrix of maximum termination values under a range of interest rate scenarios within the parameters and assumptions given by the counterparty over the life of the swap transaction. Additionally, the counterparty shall affirm receipt and understanding of the city's swap policy and that the contemplated transactions fit within the swap policy, as described. For all negotiated swap transactions, the financial advisors fair value opinion shall become a part of the official transcript.

c. Each swap resolution should provide specific approval guidelines for the swap transactions to which it pertains. These guidelines may provide for modifications to the approved swap transactions, provided such modifications do not extend the average life of the term of the swap, increase the overall risk to the city resulting from the swap, or increase the notional amount of the swap beyond pre-approved levels.

(10) *Counterparty approval guidelines.*

a. Eligibility.

1. The city shall enter into interest rate swap transactions only with qualified counterparties. The city shall avoid entering into contracts with derivative product companies (DPCs") that are classified as terminating or Sub-T DPCs by the credit rating agencies. To qualify as a counterparty under this policy, at the time of entry into a swap transaction, the selected swap provider(s) (i) shall be rated at least AA-

/Aa3/AA- by at least two of the three nationally recognized credit rating agencies (Standard & Poor's, Moody's, and Fitch Ratings, respectively) and shall have a minimum capitalization of $50 million, or (ii) shall be rated at least [A-/A3/A-] by two of the three nationally recognized credit rating agencies and provide a credit support annex (CSA) to the schedule to the ISDA master agreement that shall require such party to deliver collateral for the benefit of the city (a) that is of a kind and in such amounts as are specified therein and (b) that, in the judgment of the CFO/director of finance and his/her designee in consultation with the city's financial advisor, is reasonable and customary for similar transactions, taking into account all aspects of such transaction including without limitation the economic terms of such transaction and the creditworthiness of the counterparty or, if applicable, its guarantor; or (iii) shall obtain credit enhancement from a provider with respect to its obligations under the transaction that satisfies the requirements of clause (i) of this paragraph. The city shall not enter into an interest rate swap transaction with a firm that does not qualify as a Counterparty consistent with the foregoing guidelines.

2. Subsequent to entering into the agreement, if the ratings of the counterparty or guarantor should fall below the minimum credit thresholds established above, the city should have the ability to (a) require the posting of additional collateral or (b) terminate the agreement at the market.

3. The counterparty must make available audited financial statements and rating reports of the counterparty (or any guarantor or credit enhancer, as the case may be), and, in accordance with industry accepted accounting practices, must identify the amount and type of derivative exposure, and the net aggregate exposure to all parties (the city and others), along with relevant credit reports at the time of entering into a swap transaction and annually thereafter unless the counterparty, guarantor or credit enhancer is under credit or regulatory review and in that case immediately upon notice by the appropriate agencies to the entity.

b. Collateral requirements.

1. Collateral posting requirements between the city and each swap counterparty should not be unilateral in favor of the counterparty. If the ratings of the counterparty or its guarantor does not meet or falls below the ratings required herein (see subsection (n)(10)a., eligibility) the counterparty would be required to post collateral, subject to minimum threshold amounts specified by the city.

2. Eligible collateral shall be limited to permissible investments of the city, as defined in its investment policy. To the extent possible, the city will endeavor to not obligate itself to post collateral. As part of the swap transaction, the city or the counterparty may require collateral be posted to secure any or all swap payment obligations. Collateral requirements shall be subject to the following guidelines:

(i) Collateral requirements imposed on the city should not be accepted to the extent they would impair the city's existing operational flow of funds. The city should seek other remedies to satisfy counterparty requirements.

(ii) Each counterparty shall be required to provide a form of a credit support annex should the credit rating of the counterparty fall below the A-/A3/A- category by at least two of the nationally recognized rating agencies.

(iii) A list of acceptable securities that may be posted as collateral and the valuation of such collateral shall be determined and mutually agreed upon during negotiation of the swap transaction with each counterparty.

(iv) The market value of the collateral shall be determined on either a daily, weekly or monthly basis, as provided in the documentation for the swap transaction.

(v) Failure to meet collateral requirements shall be a default pursuant to the terms of the swap transaction.

(vi) The city and each counterparty may provide in the supporting documents to the swap transaction for reasonable threshold limits for the initial deposit and for increments of collateral posting thereafter. The swap transaction may provide for the right of assignment by one of the parties in the event of certain credit rating events affecting the other party. The city (or the counterparty) shall first request that the counterparty (or the city) post collateral, or provide a credit support facility. If the counterparty (or the city) does not provide the required credit support, then the city (or the counterparty) shall have the right to assign the agreement to a third party acceptable to both parties and based on terms mutually acceptable to both parties. The credit rating thresholds to trigger an assignment shall be included in the supporting documents.

(11) *Management of swap transaction risks.* Certain risks will be created as the city enters into swap transactions with counterparties. Some swap transaction risks, in general, are described in appendix A, summary of swap transaction risks, which is not set out herein. In order to manage the associated risks, guidelines and parameters for certain risk categories are as follows:

a. Counterparty risk. The risk of counterparty default can be reduced by limiting swap transactions between the city and any single counterparty. The city shall endeavor to minimize counterparty risk by establishing strong minimum counterparty credit standards (see subsection (n)(10)a., eligibility). In addition, the city may mitigate counterparty risk by requiring the counterparty to post collateral on a marked-to-market basis, in accordance with the guidelines described in subsection (n)(10)b., collateral requirements.

1. Exposure limits. The city should endeavor to diversify its exposure to counterparties. To that end, before entering into a swap transaction, it should determine its exposure to the relevant counterparty or counterparties and determine how the proposed transaction would affect the exposure. The exposure should not be measured solely in terms of notional amount, but should also consider how changes in interest rates would affect the city's exposure based on all outstanding swap transactions by the city. In weighing its exposure to different counterparties, the city may give more weight to a certain contract based on its periodic marked-to-market value under current interest rate levels.

2. Transfer. If an agreement eliminates the city's ability to transfer the swap to an acceptable alternative counterparty (i.e., eliminates the city's right to assign the agreement) then the city should have the right, but not the obligation, to terminate the swap without cost to the city.

b. Termination risk.

1. Optional termination. The city shall have the right to optionally terminate a swap transaction at any time over the term of the swap transaction (elective termination right) at the then-prevailing market value of the swap. Termination value shall be readily determinable by one or more independent swap counterparties, who may assume the swap obligations of the City in the event of an assignment. A counterparty shall not have the elective right to terminate a swap transaction unless a termination option has been priced into the terms of the swap transaction. The finance department may, but is not required to, explore the economic viability of a unilateral termination provision without being exposed to a termination payment.

2. Credit related termination. Upon the occurrence of a counterparty default, the city may be required to make a termination payment to the counterparty. It is the intent of the city not to make a termination payment to a counterparty failing to meet its contractual obligations unless the city is contractually obligated to do so. When a swap dealer is the affected party (the defaulting party), as defined in the ISDA master agreement, the

swap transaction may set forth a suitable time period during which the city may evaluate whether it is financially advantageous for the city to obtain a replacement counterparty to avoid making a termination payment. The market value of each swap transaction shall be calculated by the counterparty and provided to the city at least quarterly. The CFO/director of finance will monitor and report the market value to the city council periodically and implement an appropriate exit strategy in a timely manner, if required.

c. Amortization and rollover risk (term). Each swap transaction shall reflect as closely as possible the amortization of the underlying debt.

d. Liquidity risk. The city should consider if the swap market is sufficiently liquid (i.e., if enough potential counterparties participate actively in the market to assure fair pricing) for the type of swap transaction being considered and the potential ramifications of an illiquid market for such types of swap transactions. There may not be another appropriate party available to act as an offsetting counterparty. The city may enter into liquidity or credit agreements with liquidity providers and/or credit enhancers to protect against this risk.

e. Basis (index) risk (including tax reform risk).

1. Any index chosen as part of an interest rate swap transaction shall be a recognized market index, including but not limited to The Bond Market Association Municipal Swap Index (BMA) or London Interbank Offering Rate (LIBOR).

2. The city shall not enter into leveraged swap transactions without thoroughly analyzing the risks associated with the enhancement. The tax reform risk and impact to the city of each swap transaction shall be detailed through the counterparty disclosure requirements outlined in subsection (n)(9), form of swap transactions and other documentation.

f. Bankruptcy risk. The city's swap counsel shall disclose to the city the bankruptcy risks and issues associated with the type of counterparty and swap transaction chosen. Additionally, the city's swap counsel shall disclose to the city the bankruptcy issues associated with the method proposed for the posting of collateral.

(12) *Reporting requirements.* On at least an annual basis through the city's CAFR as required by GASB the status of all swap or debt derivative transactions shall be reported. Any such report shall include, but not be limited to, the following information:

a. All changes to swap transactions or new swap transactions entered into by the city since the last report to the city council.

b. A status report regarding the termination value of each of the city's interest rate swap transactions.

c. A summary for each counterparty of the total notional amount of each swap transaction, the remaining average life of each swap transaction, the term of each swap transaction, the authority to enter into each swap transaction, and the remaining term of each swap transaction.

d. A summary of the credit ratings of each counterparty, and those of any credit enhancer insuring or guaranteeing swap payments.

e. A list of any collateral posted by a counterparty, if any, and by the city, if any, detailed by swap transaction and in total by counterparty.

(13) *Glossary.*

a. *Basis risk.* The risk that a selected index in a swap (e.g., BMA index) is not perfectly correlated with the underlying asset or liability (e.g., the actual floating rate on the bonds) i.e. Equity: MSFT does not track perfectly with the S&P 500.

b. *Bond Market Association (BMA) Municipal Swap Index.* BMA Index is a seven-day high-grade swap index comprised of tax-exempt variable rate demand notes produced by Municipal Market Datas (MMD) extensive database. It serves as a benchmark for tax-exempt swaps, representing the relative benefit of tax-exemption when compared to taxable securities. Criteria for the index selected from over 10,000 active issues require weekly reset on Wednesday. To be considered for the index, the issue must not be subject to alternative minimum tax, must have an outstanding balance of $10 million or more, have the highest short term rating by Moody's or Standard & Poor's and pay interest on a monthly basis, calculated on an actual/actual basis.

c. *Counterparty risk.* The risk that the two principals involved in a swap transaction will not perform under the terms of the swap, taking into consideration its creditworthiness. Risk is reduced by entering into swap agreements with Aa rated providers only.

d. *Index.* Short-term benchmark rate used to calculate variable rate payments. Common indexes include the London Interbank Offered Rate (taxable) and the Bond Market Association Index (tax-exempt).

e. *International Swap Dealers Association (ISDA).* An association developed by the swap community to address major documentation issues facing the market.

f. *LIBOR (London Interbank Offered Rate).* LIBOR is the rate of interest at which banks borrow funds from other banks on short term money in the London Interbank market. Determined by the British Bankers Association, LIBOR serves as the floating rate benchmark in many swap agreements. The rate is normally calculated on an actual/360-day count basis and is not referenced in tax-exempt debt offerings. Although there are many available global indexes, LIBOR is the most common index for taxable securities.

g. *Liquidity.* The ease with which a swap participant may assign or terminate its obligations and rights under a swap. Higher costs are associated with more flexibility. Risk reduced by ISDA standards and improved liquidity to counterparties.

h. *Margin.* The spread (+/-) to the floating rate index which determines the floating leg of the swap.

i. *Notional principal amount.* The agreed upon reference amount or balance from which swap payments will be calculated. This amount is typically for calculation purposes only, since no principal is exchanged when payments are netted.

j. *Off-market swap.* A swap where the fixed rate is above or below the par market rate for a given structure. A payment from either the fixed rate or floating rate payer is necessary to affect a transaction. The par swap rate is determined by the fixed rate for a given structure, in which the value of the swap is zero. No payment by either party is necessary to enter into the transaction.

k. *Reset date and/or reset frequency.* Reset date determines on which day the floating rate for the subsequent period is set until the next reset date. Frequency determines the number of times reset dates occur in a year.

l. *Swap legs.* Either the fixed or floating cash flow involved in a swap which determines the party who pays the fixed rate and receives the floating rate and the party who pays the floating rate and receives the fixed rate.

m. *Tax risk.* The potential for higher funding costs due to a change in the taxation of interest income. Lower income tax rates would result in a reduction in the tax advantage of tax-exempt securities over taxable securities, resulting in higher tax-exempt rates and higher swap payments Higher income tax rates would have the opposite effect or lowering the BMA rate and therefore increasing the tax-exempt advantage over taxable securities.

n. *Term.* The length of time payments are exchanged from the first day of coupon accrual and ending on the maturity date; typically 1—30 years.

o. *Trade date.* The date which the counterparties agree to enter into a swap transaction, which may or may not be the effective date from which the coupon accrual begins.

(Ord. No. 090129, § 4, 3-5-09; Ord. No. 110333, § 1, 4-28-11)